III. HOMEOWNERSHIP ASSISTANCE

For most of the past century, American housing policy has successfully promoted the "American dream" of homeownership. Mainly via significant tax preferences and government creation and facilitation of an advanced housing finance system, federal policy has helped the overall homeownership rate reach unprecedented levels in the United States. But even with this success, homeownership remains out of reach for many resource-constrained low-income families. Persistent gaps also remain between white and minority homeownership rates. Given the potential of homeownership to build wealth and strengthen communities, recent public policy emphasizes extending the reach of private mortgage markets to meet the needs of traditionally underserved low-income and minority households. This chapter reviews the history of programs promoting homeownership in this country and then evaluates their effectiveness in advancing our seven policy objectives.

A. Low-Income and Minority Homeownership Needs

Homeownership in the United States has grown significantly, from 47.8 percent in 1950 to an all-time high of 67.9 percent in 2002. Middle- and upper-income households account for the vast majority of this gain, as government programs and an increasingly sophisticated housing finance system extended access to homeownership more broadly to the American public. However, recent years have seen increases in lending to low-income and minority borrowers. For instance, Duda and Belsky (2002)[16] report that from 1993 to 1999, loans to high-income buyers increased by half (52 percent), while loans to low-income buyers nearly doubled (94 percent). Also, loans to white buyers increased 42 percent, while blacks and Hispanics saw gains of 98 percent and 125 percent, respectively.

This increased lending fueled significant gains in low-income and minority homeownership rates. While non-Hispanic white households' homeownership rates increased 4 percent from 1993 to 1999, black and Hispanic rates increased 11.2 percent and 15.5 percent, respectively. Obviously, a smaller percentage gain in non-Hispanic white homeownership results in a significantly higher absolute number gain, due to the larger base, but the relative rates of increase are still significant. While representing only 15 percent of 1993 homeowners, minorities accounted for 41 percent of the net growth in owners over the next five years. Minority, first-time buyers as a share of all new buyers increased from 19 percent in 1993 to 30 percent in 1999.

Even with these gains, significant gaps in homeownership rates remain across economic and racial lines. For example, families with incomes above the median had a homeownership rate of 83

[16] All figures in the rest of this paragraph and the next are from this study.

percent in the fourth quarter of 2002, compared with a 52 percent homeownership rate for families earning below the median (U.S. Bureau of the Census 2003).[17]

Racial and ethnic gaps also persist. The most recent census data ("Homeownership Data" on the U.S. Bureau of the Census's website) show the homeownership rate for non-Hispanic white households at 75 percent—more than one and one-half times the 47 percent rate of black households. Hispanics owned homes at about the same rate as blacks (48 percent). Little more than half of the nation's remaining minority populations of all races owned homes. Minorities' mortgage application rejection rates are still well above those of whites, despite their growing access to home financing. In 2001, minority applicants were denied far more frequently than whites, with blacks being denied twice as often as whites, and Hispanics being denied one and one-half times more often than non-Hispanic whites during that year (ACORN 2001).

Considerable research has been devoted to exploring why these gaps exist. Most obviously, the literature underscores the serious impediments that income constraints and wealth shortfalls pose to homeownership (Duda and Belsky 2002). Minorities tend to have lower incomes and less wealth than non-Hispanic white households (Oliver and Shapiro 1997). Income-constrained households may be unable to meet the monthly costs of owning a home (i.e., principal and interest repayments on the mortgage, property taxes, insurance, ongoing maintenance). Low-wealth households may lack funds to meet required down payment and closing costs. Of these two major constraints, the literature suggests that the lack of wealth has a more profound effect on a household's ability to move to homeownership (Pew Partnerships for Civic Change 2001; Rosenthal 2001).

Although many sophisticated research efforts[18] have sought to control for these differences, they still have been unable to completely explain the gaps between minority and white homeownership rates. Other barriers also play a role. Evidence from paired testing studies clearly indicates that discrimination by both real estate agents and mortgage lending institutions limits the information and options available to minority homebuyers (Turner and Skidmore 1999; Turner et al. 2002a; Turner et al. 2002b; Turner and Ross 2003). In addition, low-income households frequently face difficulties in demonstrating creditworthiness, due to factors such as a lack of participation in mainstream financial institutions and past credit problems. Lack of information may also hinder low- and moderate-income households' access to homeownership, since many low-income consumers may not know enough about the home-buying process to make informed decisions. And finally, some minority households struggle with language and/or cultural barriers that raise special complications. Lenders not only may have trouble understanding the language of potential immigrant clients, but they also may be unfamiliar with acceptable practices in a borrower's native country (Listokin and Listokin 2001).

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[17] The median reflects all families that reported income for the Census Bureau's quarterly survey on homeownership.

[18] See, for instance, Courchane and Cobas (1995), and Browne et al. (1996).

A final barrier to low-income families' homeownership remains the limited supply of affordable housing in many regions and neighborhoods. Despite the many changes that have widened access to homeownership, these shortages seriously complicate lower-income households' efforts to buy homes (Collins, Crowe, and Carliner 2002).

B. Homeownership Programs in the United States

The promotion of homeownership in the United States has been a major policy concern since the Great Depression (Shlay 1993), and it has had a distinctive and persistent policy orientation. With a few notable exceptions, national homeownership policy in America has focused much more on making homeownership affordable than on creating new owner units. State and local housing policy has had more of a mixed focus, including production of new and rehabilitated units, promotion of affordable housing finance, and direct subsidy programs. The form and emphasis of subnational housing policy has typically been driven by federal programs such as the HOME Investment Partnerships program, Community Development Block Grants, the Low-Income Housing Tax Credit program, mortgage revenue bonds (MRBs) and certificates, public housing, and Section 8 rental assistance.

Some states and localities, however, have devoted significant direct resources[19] to homeownership via such mechanisms as the creation of affordable housing trust funds and matches for federal program dollars. In addition, state and/or local regulatory powers have been used to promote affordable homeownership. Land use planning, zoning, and building codes greatly affect the affordability of homeownership, and have often been used directly as a means of promoting affordable housing or as an indirect approach to restricting housing opportunity for low-income households (see Chapter 4). Finally, some jurisdictions combat housing discrimination either independently or as part of an overall human rights program.

This section examines the various approaches that have characterized government—mainly federal—homeownership policy. The supply- and demand-side typology we follow in the rental chapter has to be expanded for the purposes of considering the various tools to promote homeownership. The main supply and demand categories involve the provision of mortgage credit. Supply-side mortgage credit interventions (housing finance, regulation, and mortgage market innovations) facilitate the flow of mortgage credit in a systemic fashion, while the demand-side approaches (tax preferences and homeowner education and counseling) focus on reducing the individual borrower cost of mortgage credit and/or improving the odds that an individual can obtain mortgage credit. A third dimension, though, must be added to this typology: direct housing production, which expands the physical stock of homes available to targeted populations.

[19] See Stegman (1999) for a good overview of state and local housing programs.

1. Housing finance.

Although the American housing finance system appears to be a triumph of private-sector innovation, the framework of current mortgage markets can be traced back to Depression-era legislation. Government policy built the foundation for our current mortgage market, mainly through two tools: creation of specialized housing finance circuits and insurance. In addition, the national government has used direct and guaranteed loans, often at subsidized interest rates, albeit at a much lower volume than the first two interventions.

Federal legislation has created several “government-sponsored enterprises” (GSEs) whose main purpose is to create liquidity and lower the cost of capital for preferred investments: in this case, housing. GSEs are privately owned, publicly chartered companies that are limited to a specific set of activities in return for a range of benefits. They are typically exempt from various state and local taxes, have a line of emergency government credit, and may be exempt from federal registration requirements for various financial instruments. They are *not* directly subsidized or guaranteed by the federal government, but are typically highly rated in debt and equity markets because of a perception that they would not be allowed to fail (a so-called “implicit guarantee”). Because of their favorable market status, the GSEs’ cost of funds is close to that of federal borrowing, resulting in a lower cost to mortgage borrowers. The perceived safety of the investment also attracts more capital than might normally go into the preferred investment (mortgages), increasing the supply and reducing the cost of capital, again reducing borrowing costs for homeowners.

Insurance is the second major federal tool used to promote the supply of affordable housing finance. It reduces the risk to lenders that borrowers might default on their mortgage obligations, and has also has been used to promote the aggregation of capital (i.e., savings deposits) that can then be used by lenders to make home mortgages. Government insurance stimulates mortgage lending activity by protecting the security of lenders’ liens against the property securing the mortgage. These innovations have helped to create more affordable and accessible mortgage products and to increase availability of mortgage capital.

Finally, direct loans, often at subsidized rates, have been used to provide homeownership finance to typically low-income households. The volume of mortgage capital flowing from these interventions pales in comparison to the broader insurance and GSE production, but they are more targeted in their reach, and can assist households at much lower income levels.

Prior to the Great Depression, there was little federal involvement in the home mortgage finance system. Mortgage lenders were typically mutually owned building and loan societies and banks. Home mortgage loans took the form of short-term (usually three to five years), interest-only balloon loans that had to be refinanced or repaid in full at maturity. Generally, loans covered less than 50 percent of the property value, therefore requiring huge down payments. Given those terms, credit was scarce for many households, forcing a reliance on small building and loan societies. The community-based lending exemplified by George Bailey’s building society in the movie *It’s a*

Wonderful Life was limited because lenders were unwilling to tie up their money by investing in long-term loans to home buyers.

With the economic disruption and attendant loss of jobs, a huge wave of foreclosures hit the country during the Great Depression, and the inability of private mortgage insurers to cover the huge resulting losses triggered federal intervention. The resulting changes—which essentially federalized the housing finance system—were designed to ensure safety and soundness and increase the availability of mortgage capital. Federal policy established safety and soundness requirements for financial institutions and created a specialized housing finance system with active federal government involvement. From this general description of the New Deal mortgage finance system—a system whose structure survives mostly intact today—we turn to some of the specific institutions created during that era.

The Federal Home Loan Bank Act (1932) established a system of Federal Home Loan Banks (FHLB). The system was initially capitalized by federal funds, and members of the system included savings and loans and, to a lesser extent, mutual savings banks and insurance companies. The system provided guidance, standards, and supervision of member institutions. The Home Owners' Loan Act of 1933 authorized the FHLB governing board to provide for regulation of savings and loan institutions. Savings and loans were virtually confined to making first mortgage loans within a 50-mile radius of their home offices, but in return were given preferential tax treatment.

The FHLB system still exists today as a GSE, and provides an important specialized housing finance circuit that attracts capital into the mortgage market. Many of the restrictions previously placed on member institutions have been liberalized, but the FHLB system still provides an important source of liquidity and cheaper finance to the mortgage market. As a result of requirements in the savings and loan bailout legislation in 1989, the FHLB system now also provides a limited amount of specially targeted grants and concessionary financing to support affordable housing and community development.

The National Housing Act of 1934 established the Federal Housing Administration (FHA), which provides insurance for home mortgage loans made by private lenders. FHA's overwhelming contribution to homeownership is its basic mortgage insurance program, which encouraged broader use by lenders of what is now a fixture of the current American mortgage market: long-term, low down payment, self-amortizing loans (Struyk, Turner, and Ueno 1988).

The initial FHA insured mortgage product also helped to liberalize down payment requirements by permitting higher loan-to-value ratios. FHA mortgage insurance was responsible for expanding homeownership in the United States far beyond the ability of previous market instruments (Struyk, Turner, and Ueno 1988). Since 1934, the FHA and, later, the U.S. Department of Housing and Urban Development (HUD; FHA was consolidated into HUD's Office of Housing in 1965) have insured almost 30 million home mortgages and 38,000 mortgages for multifamily housing projects representing 4.1 million apartments ("About Housing" on HUD's website).

In 1938, Congress created a government corporation that would later evolve into another GSE—the Federal National Mortgage Association (now Fannie Mae)—to purchase FHA loans on the secondary market. Originally part of the FHA, Fannie Mae was authorized to buy FHA-insured loans to provide a stronger market for this new type of loan because, even with insurance, many financial institutions were reluctant to tie up their money by making and holding such loans over such a long period. Over the years, Fannie Mae's role was expanded to include buying mortgages from other government programs as well as conventional mortgages worth more than traditional government loan limits, reaching out to a broader cross-section of Americans.

In 1968, Fannie Mae was split into two separate entities: one that retained the original name and became a private entity, and the Government National Mortgage Association (Ginnie Mae), which remained in the government. Ginnie Mae is restricted to buying FHA- and Veterans Administration (VA)–backed loans. Fannie Mae's traditional customer base was the mortgage banking industry. The Federal Home Loan Mortgage Corporation (now Freddie Mac), established by Congress in 1970, was created to serve the savings and loan industry. As a result of the GSE modernization bill (Federal Housing Enterprises Financial Safety and Soundness Act of 1992), Freddie Mac has essentially achieved parity in form with Fannie Mae, and now generally competes with Fannie Mae for a broader customer base. Together, these GSEs have created a continuous flow of funds to mortgage lenders by purchasing mortgages that may be held in their portfolios or sold to investors as mortgage-backed securities. Increased funding of the mortgage market, combined with the reduced GSE borrowing costs, ultimately reduces the interest rate for mortgage borrowers (although the exact extent of the consumer benefit is subject to debate).

Fannie Mae and Freddie Mac's charters have always mandated a general priority for them to serve low- and moderate-income families. In the 1992 GSE modernization bill, however, Congress challenged Fannie Mae and Freddie Mac with more specific goals for meeting the credit needs of what were termed traditionally underserved populations and communities (Bunce 2002). The legislation established explicit goals, to be calibrated by HUD, for GSE service to underserved areas and households. These objectives include a low- and moderate-income goal, which targets borrowers with less than median income; the "special affordable" goal, targeting very low-income borrowers and low-income borrowers living in low-income census tracts; and geographically defined goals, targeting low-income and high-minority census tracts (Bunce 2002).

The legislation also severed HUD's general regulatory authority over Fannie Mae and Freddie Mac, granting HUD authority to set and evaluate compliance with affordable housing goals and transferring safety and soundness regulation to the newly created Office of Federal Housing Enterprise Oversight. By imposing more specific, transparent affordable housing goals, Congress felt that Fannie Mae and Freddie Mac would have very strong incentives to improve their products and business practices to meet the mortgage credit needs of more low-income households and minority/low-income neighborhoods (Bunce 2002).

The Department of Agriculture's Rural Housing Service (RHS)[20] is a good example of federal housing policy promoting homeownership through direct loans and guarantees. Created by the Housing Act of 1949, the Section 502 Rural Homeownership Direct Loan Program provides direct loans to rural homeowners seeking to purchase homes or refinance existing mortgages. In 2001, there were 547,622 loans outstanding, and approximately 15,000 new direct loans have been made annually in recent years. The Housing Act of 1949 also created the Section 502 Guaranteed Rural Housing Loan Program. Through this program, a commercial lender makes an approved loan to an eligible borrower and RHS guarantees repayment to the lender in the event that the borrower defaults. There were 215,708 units insured under this program as of April 2001. The VA also provides mortgage loan guarantees, a benefit originally created in 1944 through the GI Bill for returning World War II veterans. From 1944 through 1996, VA guaranteed 15.3 million loans.

As a final example of subsidized lending, state and local governments sell tax-exempt housing bonds, commonly known as mortgage revenue bonds (MRBs), and use the proceeds to finance low-cost mortgages for lower-income first-time home buyers (as well as affordable rental units). Investors purchase MRBs at low interest rates because the bonds produce tax-free income. State housing finance agencies then pass through the savings from reduced borrowing costs to private lenders, who then lend to first-home purchasers at reduced interest rates. Congress caps the amount of tax-exempt bonds each state can issue each year based on a formula reflecting each state's population. MRBs have made first-time homeownership possible for nearly 2.3 million lower-income families—approximately 100,000 every year. A complementary program, authorized by the 1984 Tax Reform Act, is the mortgage credit certificate program. This program makes more direct assistance to eligible borrowers through a tax credit that directly reduces tax liability, dollar-for-dollar.

2. Regulation.

The federal government regulates[21] financial institutions to increase the availability and affordability of homeownership to lower-income and minority borrowers and communities. Tools discussed can be considered supply-side interventions facilitating the flow of mortgage credit. Federal regulations use a variety of techniques, including goals, data collection and reporting, enforcement, and incentives.

Virtually all these techniques target increased lending or housing opportunity for specific populations and/or geographic areas. Goals may be stated generally, identifying the desired behavior, or specifically, setting specific numeric or percentage of business benchmarks. Typically, these goals are set for individual firms, and then a regulator conducts *ex post facto* reviews to evaluate performance. Collecting and reporting data is also used as a regulatory tool, creating opportunities for public attention to and evaluation of industry and/or individual institutional

[20] Formerly the Farmers Home Administration.
[21] In the context of this discussion, the term "regulation" does not refer to specific executive branch rule-making implementing and enforcing legislation. Rather, it refers more broadly to the use of public power, through the enactment and implementation of public policy, to influence and change private behavior, with a goal of producing more desirable outcomes.

performance. Enforcement is used to sanction firms that violate the law, and may be triggered by such techniques as paired testing to detect illegal discriminatory treatment. Finally, incentives are used to encourage institutions to voluntarily engage in desired behavior.

The most significant regulatory efforts to expand homeownership have centered on influencing private mortgage market institutions by creating goals for their performance in meeting the credit needs of low-income minority households.[22] Intended to prevent and reverse the effects of decades of redlining—the practice of not lending to particular geographic areas based on racial composition—and urban disinvestment, the Community Reinvestment Act (CRA), enacted in 1977, required federally insured depository institutions to meet the credit needs of the communities in which they are chartered, including low- and moderate-income neighborhoods.

In return for extensive federal backing and support (i.e., deposit insurance, Federal Reserve Board backing, etc.), CRA established three requirements. The law reaffirmed the responsibility to meet community credit needs, directed regulators (Federal Deposit Insurance Corporation, Federal Reserve Board, Office of Thrift Supervision [formerly part of the Federal Home Loan Bank Board], and the Office of the Comptroller of the Currency) to examine and rate the institutions' performance, and permitted regulators to sanction institutions with weak records. Most lenders' activities in response to CRA fall into one of two categories—increased lender outreach to qualified borrowers, and the modification of their underwriting guidelines to reach those who don't qualify under traditional criteria (Avery, Bostic, and Canner 2000). It was hoped that requiring depository institutions to provide more lending opportunities in their communities would provide a powerful revitalization tool for inner cities (Haag 2000).

The prime example of encouraging homeownership by data collection and reporting, the Home Mortgage Disclosure Act (HMDA), preceded CRA by two years. Congress enacted HMDA in 1975, responding to concerns that some depository institutions were not making mortgage loans to qualified borrowers on reasonable terms and conditions, therefore contributing to the decline of many urban neighborhoods. While originally applicable only to depository institutions and their direct subsidiaries, the scope of HMDA coverage has expanded over the years to include most mortgage lending institutions, including savings and loans, independent mortgage banking companies, and mortgage banking subsidiaries of commercial bank holding companies. Today, HMDA reporting captures most mortgage market transactions.

Originally, HMDA sought to illuminate disparate geographic lending patterns of financial institutions so that the public could choose where to save their money and to help public officials direct public resources to underinvested areas. Thus, HMDA reporting was originally confined to

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[22] Two examples of the use of goals to promote homeownership opportunity have already been discussed: Fannie Mae and Freddie Mac have various goals to promote minority and low-income homeownership, expressed as percentages of business to be devoted to traditionally underserved populations. In addition, the FHLB system is required to devote a percentage of its revenues to a number of special programs designed to promote affordable housing and community development. These programs were discussed above in more detail, and are therefore not addressed in this section.

identifying the areas where reporting institutions were making their loans. In response to concerns about discrimination, Congress amended HMDA in 1989. The amendments substantially expanded reporting requirements to include the race/ethnicity, gender, and income of applicants for mortgage credit. In addition, Congress required that applications not resulting in the extension of credit, including reasons for denial, be reported, as well as the secondary market disposition of loans made or bought and sold in the same year. In response to concerns about abusive lending practices, most notably in the cost of loans, the Federal Reserve Board is implementing changes to HMDA reporting to require inclusion of loan pricing information.

HMDA data make possible virtually all of the studies and reports that examine lending patterns by race/ethnicity, gender, and income. Research over the years has repeatedly uncovered disparities in loan denials by race/ethnicity and income, even controlling for the basic economic variables collected by HMDA. HMDA has focused the public spotlight on fair lending issues raised by persistent loan denial rate disparities.

The Fair Housing Act, contained in the Civil Rights Act of 1968, prohibits discrimination in the sale, financing, or rental of housing because of race, color, religion, sex, or national origin.[23] Under the act, as modified in 1988, individuals who believe they have been discriminated against can pursue specified administrative and judicial remedies.

Despite legal protections, the federal government's role in fair housing enforcement has been limited (Kushner 1992). Overall, funding for federal fair housing efforts has been inadequate to mount an aggressive assault on housing discrimination. Critics have charged that HUD's fair housing operation is essentially a stepchild in the department, and various administrations' priorities have not permitted a consistent long-term enforcement approach to be developed. Private fair housing groups have typically brought the most significant litigation.

3. Mortgage market innovation.

Mortgage market innovation by nongovernmental players also has opened many opportunities, although it is difficult to distinguish changes that are entirely private from those that evolved in response to public policies. Because these innovations tend to be systemic to the housing finance industry, they can be grouped under the general category of supply-side approaches to providing mortgage credit.

The most important market innovation that expanded both the availability and affordability of mortgage capital is, without question, the advent of securitization.[24] In the 1970s and early 1980s, the housing finance market experienced several financial shocks, including extraordinarily high interest rates. The mortgage markets were dominated by thrift institutions that borrowed short term

[23] 1988 amendments extended the original coverage of the Fair Housing Act to protect the disabled and families with children.
[24] The discussion on securitization draws on Kent Colton's 2003 analysis of what he calls the "second revolution" in American mortgage markets.

via customer deposits and lent long term via mortgage loans. The high interest rates necessary to attract customer deposits outstripped the returns thrifts could realize from mortgage lending, leading to structural imbalances that often produced capital shortages for mortgage lending.

The Report of the President's Commission on Housing (1982) recognized and addressed this issue by recommending a series of measures to better connect mortgage markets to capital markets, seeding the growth of a fledgling secondary market in mortgage-backed securities. The previous housing finance system was primarily funded by customer deposits to thrifts that then made mortgage loans to borrowers, holding the loans in portfolio and making profit on the difference between the cost of funds (i.e., interest paid on deposits) and the revenue from interest paid on mortgages. The President's Commission envisioned a radical expansion of a limited market in mortgage-backed securities, through which pools of mortgages with similar characteristics could be packaged and sold as securities, reaching a wider market of investors. This wider investor base would result in greater availability and continuity in the capital supply for mortgages, ensuring lower interest rates and a continuous supply of capital. Congress enacted much of the program recommended by the President's Commission in the Secondary Mortgage Market Enhancement Act of 1984.

Based on these changes, the American housing finance system has evolved to a point where the availability of mortgage capital is no longer a concern. The evolution and maturation of a robust secondary market helped to stimulate record homeownership rates, allowed record levels of mortgage originations to continue despite problems in global financial markets, and led to the dominance of GSEs—Fannie Mae and Freddie Mac—in the mortgage market.

In addition to issuing securities, GSEs, as part of their housing mission, have created new debt strategies to attract more mortgage capital. An important part of integrating global capital markets with the mortgage markets is the ability to provide investors convenient mechanisms for buying and selling the debt securities that finance housing. To help meet investors' needs, Fannie Mae and Freddie Mac have pioneered innovative debt securities, as well as creative new ways to market, manage, and create exchanges for their debt.

These innovations have increased both the flow and affordability of mortgage credit. Innovations in mortgage products have also extended the availability of finance to low-income households. FHA's contribution to the use and acceptance of the 30-year, fixed-rate, self-amortizing mortgage is the gold standard example. Although product innovation has led to the creation of many alternative mortgages, such as adjustable rate and 15-year mortgages, the most compelling advance that has benefited first-time and low-income home buyers has been the widespread availability of low down payment mortgages.

Typically, mortgage lenders view mortgages with loan-to-value (LTV) ratios of less than 80 percent to be safe investments because the borrower's equity is considered to be a powerful predictor of whether or not they will default on their mortgage. Due to the greater risk of loans with LTVs higher than 80 percent, the GSEs' charters actually require that they manage that risk differently than with lower LTV loans. From this requirement, a private mortgage insurance (PMI) industry has evolved that, for a fee, insures the lender for the loan amount above 80 percent LTV. More recently, the GSEs have developed the capacity to more accurately predict the additional risk of loans above 80 percent LTV, and thus can price their business to account for that risk.

Both of these developments, in turn, have led to the massive expansion of the market for so-called high-LTV loans. Essentially, the down payment barrier, shown earlier to be one of the biggest constraints to homeownership for low- and moderate-income households, has been all but eliminated for the price of either PMI or slightly higher interest rates (Rosenthal 2001). Although low-income households long faced problems saving enough to put 20 percent down, a down payment of 3 to 10 percent makes homeownership far more attainable. Of course, loans must be paid back, and higher-LTV loans mean higher mortgage payments, particularly with PMI payments or higher interest rates charged for increased default risks associated with high-LTV loans.

Two other market innovations also merit attention: technology and risk-based pricing. The massive quantities of data on mortgage payment behavior that have been collected as part of the mortgage business have led to increased ability to better predict payment behavior and default risk. Combined with advances in technology, this increased knowledge has been employed to automate underwriting processes. Most notably used by Fannie Mae and Freddie Mac (although other major mortgage finance institutions have also developed systems reflecting their own underwriting criteria), automated underwriting systems now dominate the origination business.

This increased understanding of consumer mortgage payment behavior has led to more sophisticated and refined underwriting criteria that are codified in software systems reflecting investor guidelines about what mortgages to make. This new generation of underwriting criteria, driven by knowledge and regulatory pressures to liberalize underwriting criteria, has arguably reached low-income borrowers who would have previously been denied mortgage credit (Gates, Perry, and Zorn 2002). In addition, automation has removed human bias—direct and indirect—from the system, which many have argued is a significant source of disparate treatment of minorities.

This combined advance of automation and application of more refined knowledge of consumer payment behavior is beginning to be applied in the servicing arena, also. Systems have been developed that allow servicers to more quickly identify and contact delinquent borrowers who are serious default risks, offering workout solutions tailored to their individual circumstances. This development is particularly critical to low-income borrowers, who may be more vulnerable to default due to more highly leveraged home loans and precarious incomes.

A final market innovation that holds promise—but also poses risks—is risk-based pricing of loans. The American mortgage market has typically had a threshold for borrowers—either an applicant qualified for a prime loan, typically meeting the GSEs' underwriting criteria, or not, and had few other options. Those other options typically involved subprime lenders that could charge significantly higher interest rates to compensate for the increased risk and because of lack of market competition. In recent years, particularly as national homeownership rates have increased to record levels, the prime market has almost reached saturation levels, making the market for subprime loans more attractive for mortgage lenders.

Unfortunately, this relatively undeveloped market has attracted players who engage in predatory practices designed to strip equity from homes. Many engage in blatantly illegal practices, but in addition, practices such as balloon payments, higher interest rates, and prepayment penalties—loan terms that are not, by definition, bad and, in fact, could be used beneficially—are combined and packaged in ways that take advantage of unwary borrowers.

4. Tax preferences.

Tax code–related subsidies have provided major support for homeownership for nearly a century. These subsidies can be considered as a demand-side intervention for mortgage credit, reducing the cost of credit for individual borrowers. These include the mortgage interest and property tax deductions, capital gains exclusions, and the exclusion of imputed rental income. The notion that American housing policy—principally expressed in the form of tax preferences—is skewed toward homeownership has become an accepted article of faith. Interestingly, these preferences were not originally enacted specifically to promote homeownership.[25] Rather, their purpose and political dominance evolved through the growing influence of the industries surrounding homeownership, the increasing dominance of homeownership as the "tenure of choice" for most Americans, and increasing house prices.

Federal tax preferences supporting homeownership come principally in three forms: deductions, deferrals, and exclusions. Tax deductions permit taxpayers to deduct certain expenses from their taxable income, thus reducing the amount of income subject to taxation. Tax deferrals permit normally taxable income to be sheltered from taxation until some future point in time. Tax exclusions eliminate normally taxable income from taxation.

The mortgage interest deduction (MID) is a federal tax deduction for interest paid on a mortgage used to buy, build, or renovate a residence. Typically, the MID is considered the major tax preference supporting homeownership, representing projected 2002 tax expenditures[26] of $69.9 billion under current law (Joint Committee on Taxation [JCT] 2002). When a federal income tax was first enacted in 1913, the legislation permitted taxpayers to deduct consumer interest, with no special provision or distinction for mortgage interest. The 1986 Tax Reform Act (TRA), in fact, was the first major codification of this evolving distinction of types of interest, enshrining the primacy of mortgage interest over other forms of consumer debt by preserving the MID and eliminating other consumer interest expense deductions.

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[25] This discussion of the origins of homeownership tax preferences draws heavily on Carliner (1998) and his excellent analysis of the origins and purposes of homeownership tax provisions.

[26] "Tax expenditures" are defined under the Congressional Budget and Impoundment Control Act of 1974 as "revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability.''

The federal property tax preference is the second costliest homeownership preference measured by the JCT, costing a projected loss of $22.1 billion in 2003 federal tax revenue (JCT 2002). As was the case with mortgage interest, state and local property taxes did not enjoy any special status or distinction from other state and local taxes and their deductibility for federal income tax purposes. In response to the same influences that maintained the MID, the 1986 TRA preserved the deductibility of property tax expenses for homeowners while striking the deductibility of various other state and local taxes.

The third major homeownership tax preference protects capital gains realized from selling a home. If a homeowner sells their house for a price, adjusted for improvements and sales transaction costs, more than the original price paid, they realize a capital gain. While tax rates can vary over time and type of capital gains, this income is normally taxable. The Taxpayer Relief Act of 1997 allowed taxpayers of any age to exclude $500,000 of capital gains if filing jointly (or $250,000 otherwise) on the sale of a home an unlimited number of times, as long as the home was used as a principal residence for two of the past five years.

The final major homeownership tax preference is not widely recognized as a benefit: the exclusion of imputed rental income. Homeowners receive two forms of benefit from their equity investment in their home: capital gains from house price appreciation and housing services from the shelter provided by the home. While homeowners live rent-free, they are, in fact, simultaneously owners and "renters." As their own "landlords," homeowners receive "rent" in the form of the market value of the shelter provided by their home. In essence, economists argue that homeowners engage in a barter transaction with themselves, accepting these housing services in lieu of "dividends" on their equity investment. The value of this benefit is termed imputed rental income, and is excluded from taxation. Estimates place the cost of imputed rent at about $140 billion (Green and Reschovsky 2001).

Although the general trend in federal tax policy has been to liberalize benefits for homeowners, the value of the deductions and exclusions are indirectly affected by changes in marginal tax rates. For instance, marginal tax rate reductions enacted in TRA 1986 and more recent legislation indirectly reduced the value of homeownership tax preferences by making these deductions less valuable. Another TRA 1986 reform effectively precluded many lower-income households from using various homeownership preferences, notably the MID and the property tax deduction. In an effort to simplify tax preparation, this legislation raised the standard deduction. Many low-income households' deductions do not exceed the standard deduction, so they do not itemize and thus cannot take advantage of deductions such as the MID.

5. Homeowner education and counseling.

Buying a home and securing a mortgage are among the biggest financial transactions that most Americans make in their lifetime. Ranging from basic educational materials to pre- and postpurchase counseling and foreclosure prevention, homeowner education and counseling (HEC) has emerged as a widely used type of homeownership assistance that can be provided as a standalone offering or as a prerequisite to affordable financing. Counseling benefits lenders in two ways. First, it helps qualify potential homeowners, since it is usually a prerequisite for affordable financing and mortgages. Second, HEC provides a way for lenders to connect to communities, thereby meeting some CRA requirements, through partnerships with community-based organizations and nonprofits that run HEC programs.

Less widespread than other types of HEC are efforts to sustain homeownership through foreclosure prevention. These efforts have become increasingly important, as homeownership has been promoted more and more among populations that traditionally have not owned homes. In fact, as the number of defaults has increased in the past couple of years (Leonhardt 2001), more programs are looking to establish ongoing post-purchase counseling to try to forestall defaults and foreclosures before a problem arises (Elugardo and Klein 1998). Mortgage foreclosure prevention is emerging as a new component of HEC, and lenders are doing more now than they have in the past to provide solutions for borrowers who may be in jeopardy of defaulting on their loans.

6. Housing production.

Supply-side interventions for homeownership have predominantly focused on increasing the supply of affordable housing finance. The federal government, however, has promoted homeownership through direct subsidies that localities and nonprofits use to expand the stock of affordable housing by physically building and rehabilitating homeownership units. The two main funding vehicles are the Community Development Block Grant (CDBG) and HOME programs. Of the six approaches discussed, housing production is the only supply-side intervention that actually seeks to expand and preserve the physical housing stock.

The Housing and Community Development Act of 1974 created the CDBG program, combining many of the New Frontier and War on Poverty single-purpose grant programs created in the 1960s into one block grant to states and localities to fund economic and community development programs. There are many eligible uses for CDBG funding, and decisions on how to distribute that funding are made by local governments. An overarching rule is that at least 70 percent of funds must be used for people with low or moderate incomes. The program has been split into parts for entitlement cities—larger jurisdictions that receive annual funding based on a formula—and small cities, for which grants originally were awarded directly from HUD and now are funneled through states.

The HOME program, established in 1990, provides formula grants to states and localities. Communities use them—often in partnership with local nonprofit groups—to fund a wide range of activities that build, buy, and/or rehabilitate affordable housing for rent or homeownership or provide direct rental assistance to low-income people. Participating jurisdictions may use HOME funds for a broad range of eligible activities: to provide home purchase or rehabilitation financing assistance to eligible homeowners and new home buyers; to build or rehabilitate housing for rent or ownership; or for "other reasonable and necessary expenses related to the development of non-luxury housing," including site acquisition or improvement, demolition of dilapidated housing to make way for HOMEassisted development, and payment of relocation expenses (“HOME Quick Facts” on HUD’s website). HOME has funded creation, rehabilitation, or purchase of 627,000 units of housing.

B. The Performance of Homeownership Programs

How well do efforts to promote homeownership conform to the seven objectives of a housing policy that supports families and communities? A review of the literature on low- and moderate-income and minority household homeownership reveals that programs to expand homeownership among underserved groups advance the seven-policy agenda to varying degrees. Literature evaluated has come from a variety of sources, including government agencies as well as academic and research institutions. The literature includes program evaluations, policy papers, and original research.

In general, research in this area examines specific demand-side mortgage credit programs geared toward targeted populations. Many demand- and most supply-side mortgage credit interventions tend to be more broadly targeted, benefiting a wider range of households. Research on these categories has therefore generally tended to focus on system wide effects, with some emphasis on distributional effects across income, race, and ethnicity. Research on supply-side housing production programs is scarce, reflecting the limited scope of these efforts. This literature typically focuses on basic benchmarking, such as simply identifying how many homeownership units were produced under the umbrella of broader block grants.

1. Preserve and expand the supply of good-quality housing units.

The creation of affordable new homes and the rehabilitation of existing owner-occupied units have not been the primary focus of homeownership policy in the United States, nor has it been a major research issue. This makes it difficult to accurately assess the impact of efforts to promote homeownership on the overall supply of affordable housing units (Collins, Crowe, and Carliner 2002). A general discussion of the evidence reveals, however, that demand substantially outpaces supply, and that homeownership assistance programs contribute only modestly to the preservation and expansion of quality housing unit supply.

Evidence suggests that the supply of affordable owner units is not keeping pace with demand. A study of 17 metro areas showed that more than 200,000 working families[27] could afford a home priced between $50,000 and $75,000, yet only 30,000 homes were available in that range (Stegman, Quercia, and McCarthy 2000).

Collins, Crowe, and Carliner (2002) note three ways homeownership units can be added to the affordable housing stock, finding that none substantially increase the numbers of homes available for purchase. Building new units is the most direct way to increase the supply of dwellings

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[27] Working families, in this study, were defined as earning between $10,700 a year and 120 percent of the local area’s median income.

available for purchase. However, just over 500,000 new affordable owner units[28]—30 percent of new units in the period—were added to the housing stock between 1997 and 1999. More than two-thirds of these units were mobile homes. Affordable homes can also enter the market through the filtering down of higher priced units as they lose value due to age and other factors. However, more units filtered up than down between 1997 and 1999: For every one unit decreasing in price, 1.4 units experienced a price increase. Finally, units can be converted from rentals to ownership. During this time frame, 1.4 million rental units were converted to ownership units, and 1.25 million ownership units were converted to rental, for a net gain of just 153,000 owner units.

Against this backdrop of a market shortage of affordable homes, the HOME and CDBG programs have supported a limited level of construction and rehabilitation of homes. However, at least one program evaluation suggests that more of these federal funds have gone to programs that finance rental housing and assistance programs, despite the recent push to increase homeownership. One review of the HOME program revealed that between 1992 and 1995 the percentage of state HOME funds used for the acquisition, construction, or rehabilitation of rental units increased from 49 percent to 57 percent (Urban Institute 1998). Meanwhile, programs producing new owner-occupied units saw their share of the funds decrease by half, from 33 percent to 16 percent. The share of the money allocated toward home-buyer assistance programs increased from 13 percent to 23.3 percent—but across the whole program, the money dedicated to producing or rehabilitating new units and fostering homeownership decreased from 43 percent in 1992 to 39 percent in 1995.

Since 1974, about 28 percent of CDBG funds has gone to housing, both rental and homeownership, with 35 percent of fiscal year 2001 funding being used for this purpose (Millennial Housing Commission 2002). These funds supported 172,445 housing units, of which 3,878 units were newly constructed, 11,812 were sold to first-time home buyers, and 156,755 were rehabilitated units (Richardson 2002).

Policies and programs promoting easier, cheaper, and more consistently available mortgage credit certainly provide indirect support for new building construction. Whether this resulting enhanced demand preserves or expands affordable homeownership opportunities is unclear. On one hand, more affordable credit can redefine what house price is affordable. If a family's borrowing costs are cheaper, they can afford to buy a more expensive house, all other things equal. Increasing demand by providing cheaper credit, however, can exert upward pressure on house prices, pushing them beyond an affordable range for many families. With many other factors influencing house prices and incomes, both of which help define homeownership affordability, discerning the impact of supply- and demand-side mortgage credit programs on this goal is difficult.

[28] Defined as units that would be affordable to a household earning 80 percent or less of the area median income.

2. Make housing more affordable and more readily available.

The literature confirms that making mortgage credit more affordable and available generally has been effective in expanding access to homeownership. A review of these mortgage credit approaches suggests that entitlements, particularly tax preferences available to broad swaths of American homeowners—while more politically sustainable—may not fit the realities facing low-income households. More narrowly tailored approaches, such as goals specifically geared to target populations, appear more effective in promoting affordability and availability of mortgage credit to these groups.

Duda and Belsky (2002) concluded that regulatory oversight (such as increased enforcement of both CRA and HMDA), increased GSE lending goals, and FHA mortgage insurance have all played a major role in increasing low-income homeownership. Duda and Belsky note that the homeownership gains seen in recent years by these households cannot be explained by socioeconomic and demographic changes alone.

During consideration in Congress of a major financial modernization bill, extensive, often-acrimonious debate occurred on the effectiveness of CRA. While many argued that CRA was not cost-effective, research has suggested that CRA requirements have changed the behavior of covered lenders. For instance, research conducted by the Harvard Joint Center for Housing Studies found that CRA-regulated lenders had higher market shares of home purchase lending to low-income and minority households in their communities than noncovered and out-of-area institutions (Apgar and Duda 2002). In addition, CRA performance has been raised in the public hearing process required for regulatory approval of bank expansions. Although an accurate estimate of impact is difficult, a representative of community groups that use this public process to leverage commitments from covered financial institutions estimates that this process has produced in excess of $1 trillion in lending commitments from 1977 to 2000 (National Community Reinvestment Coalition 2002) Finally, a review of CRA literature on its spatial and population impact (Haag 2000) found that various amendments to the CRA seem to have increased both the number of loans made to low- and moderate-income and minority households and the lending activity in low- to moderate-income census tracts.[29]

When CRA was passed, banks and thrifts were the major source of mortgage loans, and relied heavily on their community deposit base to aggregate capital for mortgage lending. Over time, with the relaxation of geographic restrictions on interstate banking and the consolidation of the financial services industry, CRA has covered a progressively smaller base of mortgage lending activity. For instance, in 2000, less than one-third (29.5 percent) of all home purchase loans were made under the regulatory regime of CRA, down from 36.1 percent in 1993 (Apgar and Duda 2002). Given the relative success of CRA, there are now many calls to modernize the CRA system to keep pace with the massive changes in the structure of the financial services industry.

[29] However, the literature also shows that increases in mortgage lending to minorities has occurred among lenders not subject to CRA requirements (Bostic and Surrette 2000), which suggests that these increases may have been driven at least partly by market forces and a favorable financial climate.

The creation of the FHA and the establishment of new goals for the GSEs have also been found to have expanded homeownership (HUD 2000a; Bostic and Surrette 2000; Duda and Belsky 2002), though there is evidence that the GSEs trail conventional lenders when it comes to funding affordable loans (Bunce 2002).[30] Bunce also found that although the FHA represented a relatively small share of the total market—insuring between 19 and 20 percent of all home loans in 2000—nearly 38 percent of its insurance covered loans to black and Hispanic households, and nearly 49 percent supported low-income borrowers. HUD's 2000 study examining FHA's performance found that in 1999, half of all FHA borrowers had low incomes and more than a third were minorities (HUD 2000a). Home buyers in underserved neighborhoods, moreover, received over 42 percent of FHA loans, compared with just 26 percent of conventional loans and 21 percent of GSE loans. Listokin et al. (2001) found that FHA loans were the "most potent mortgage products offered" and reported that black and Hispanic renters saw their absolute home-buying capacity nearly quadruple and triple, respectively, when they obtained more liberal loan products, including FHA loans.

Questions remain, however, about whether FHA loans actually expand homeownership or just accelerate renters' move to it. Goodman and Nichols (1997), for example, suggest that the main impact of FHA programs is merely to accelerate homeownership by helping households that would have eventually qualified for homeownership achieve it sooner. At the same time, these authors agree that that FHA initiatives increase the amount of housing that can be purchased by households and reduce the total cost of owning a given house (at least for some borrowers).

Mortgage market innovation has clearly expanded access to mortgage credit for low-income households. Literature on affordable lending products presents a case study on the market's success, while highlighting remaining challenges. Research suggests that product innovation—principally underwriting liberalization—has expanded both home-buying capacity (i.e., access to mortgage credit sufficient to buy a target-priced home) and renter affordability by a factor of two, compared with pre-1990 mortgage products (Listokin et al. 2001). Despite these gains, this analysis suggests that even the most aggressively liberalized mortgage products still do not reach four-fifths of the renter population. Research analyzing the impact of remaining down payment barriers (Rosenthal 2001) suggests that product liberalization to reach low-income households has reached practical limits. Both these findings illuminate the low incomes and negligible wealth of most renters, highlighting the fact that, absent income and wealth-creating strategies, homeownership is not for everyone.

Technological advancements have also expanded affordable lending by increasing the efficiency of mortgage origination and servicing, thus lowering the cost of credit. Innovations such as automated underwriting and servicing have been found to increase the number of eligible borrowers (Gates, Perry, and Zorn 2002). Automation has also removed human bias from the application of

[30] Both Fannie Mae and Freddie Mac dispute these findings and note that they have conducted similar analyses, which show that they match or exceed the conventional market. See Fannie Mae (2000) and Freddie Mac (2000) for the GSEs' response to HUD's findings. HUD's position can be found in HUD (2000b) and Bunce (2000; 2002).

underwriting criteria, which critics long argued produced intentionally and unintentionally biased results.

Yet technological progress does not come without limitations. Large parts of the mortgage market can be handled through automated underwriting, which relies heavily on credit scores. Thus, the automation is premised on a borrower building a credit history and other characteristics that are readily available electronically. Bostic and Surrette (2000) note that this automation can place credit-constrained households at a disadvantage. Nontraditional borrowers may not fully participate in the mainstream economy, and as a result may have blemished, incomplete, or nonexistent credit histories. Although liberalized underwriting criteria may still permit mortgage credit to be extended, these loans may require manual processing to supplement the initial automated underwriting. Because automated underwriting has drastically reduced origination costs in a very competitive, thin-margin business, the cost structure of the process is biased against more difficult-to-underwrite loans, even if the prospective borrowers ultimately are creditworthy.

Homeownership education and counseling efforts receive more mixed reviews in the literature than pro-homeownership policies—even though the HEC industry has grown tremendously and is seldom criticized. Nevertheless, until recently, little evidence indicated that HEC helps to reduce the number of foreclosures and defaults (Mallach 2001; McCarthy and Quercia 2000). These programs do, however, increase borrowers' creditworthiness and mortgage readiness, and often help to match home buyers with lenders. These outcomes alone, which can help borrowers qualify for a mortgage and a better interest rate, make HEC valuable to achieving the goal of making existing housing more affordable and available.[31] More recent research (Hirad and Zorn 2002) has suggested that, in fact, the right kind of counseling and education can reduce delinquencies and default rates. Armed with this knowledge, underwriting criteria can be adjusted to qualify more borrowers who normally might not be extended credit.

Additional questions revolve around the certification standards for HEC programs, HEC curriculum, the financing of HEC activities, and most fundamentally, what programs are effective. Hirad and Zorn focused entirely on the effectiveness of prepurchase counseling.[32] While they found that this counseling can significantly reduce delinquency rates, not all counseling programs proved equally successful. Borrowers who receive individual counseling had a one-third reduction in delinquency rates, while borrowers receiving classroom and home study had 26 percent and 21 percent decreases, respectively. Telephone counseling was found to have no statistically significant effect on 90-day delinquency rates.

The biggest demand-side mortgage credit intervention—tax preferences—do not work as well for low-income homeowners. Though highly beneficial to higher-income segments of the owning population, tax preferences and programs have done less to promote homeownership among low-income homeowners than financial policy and market changes (Green 1997). Several studies

[31] The true impact of HEC is unclear, though. In many cases, HEC may just be accelerating homeownership rather than expanding the pool of homeowners (McCarthy and Quercia 2000).
[32] They used the terms counseling and education interchangeably.

indicate that the mortgage interest deduction and nontaxation of imputed rent have done little to improve homeownership rates among lower-income households because these households see few of the intended benefits (Green 1997; Case and Marynchenco 2002; Collins, Belsky, and Retsinas 1999; McCarthy, Van Zandt, and Rohe 2001).

As was noted previously, most lower-income taxpayers do not itemize their deductions—a prerequisite for tax-related homeownership benefits—because it makes more sense for them to take the standard deduction (Bourassa and Grigsby 2000).[33] The ability of tax preferences to make housing more available and affordable is further limited because the initiatives do nothing to help lower-income borrowers overcome the two major barriers they face: their deficits of income and wealth (Collins, Belsky, and Retsinas 1999). Tax programs also do little to offset the risks associated with homeownership in poor neighborhoods (Ambrose and Goetzmann 1998).[34]

3. Promote racial and economic diversity.

Research suggests that supply-side housing production programs that promote affordable homeownership in poor neighborhoods do little to promote racial integration, even if they facilitate economic integration (Cummings and DiPasquale 2001). The impact of supply-side mortgage credit interventions on promoting affordable homeownership is more difficult to assess, as they mostly promote the general availability and affordability of mortgage credit without explicit regard to spatial impact. The general criticism of the collective impact of the overall housing finance architecture created by federal intervention has more to do with overall patterns and evolution of the business. In essence, the charge has been successfully levied that the restructuring of and consolidation in the financial services industry has led to a withdrawal from many poor, urban, and minority communities.

This trend, captured in the relatively recent term “underserved,” spurred a number of regulatory[35] interventions (most notably CRA, HMDA, and GSE affordable housing goals) designed to increase capital flows to these areas. These responses may promote economic diversity in underserved areas by allowing higher-income households to either remain in or move into these communities. On the other hand, increased availability and affordability of mortgage credit may in fact promote economic diversity via increased low-income mobility. Analysis conducted by Duda and Belsky (2002) and JCHS (2001), reveal substantial progress toward economic integration, as large percentages of low-income and minority households have located in middle-income tracts and the suburbs.

The performance of supply-side interventions in mortgage credit in promoting racial integration is more troublesome. In general, racial integration remains rare, as whites and Asians

[33] Bourassa and Grigsby (2000) found that 90 percent of the benefit attributed to interest rate deductions goes to homeowners with incomes over $50,000, because most lower-income owners find that taking the standard deduction is more beneficial than itemizing.
[34] Their major argument is that targeted lending will do little to increase homeownership rates without major subsidies to offset the potential risk of equity loss.
[35] Consistent with the previous use of this term, “regulatory” is meant to capture both legislative and executive branch actions seeking changed outcomes and/or behavior.

have been found to disperse to a greater extent than blacks and Hispanics. These latter groups tended to buy in areas where they made up a majority of the population (Duda and Belsky 2002). Similarly, minorities who own homes are more likely to do so in the central city (Gyourko, Linneman, and Wachter 1999), even though low-wealth white homeowners locate slightly more frequently in the suburbs.

FHA's success is tempered by its history of racially biased underwriting criteria and the spatial impact of FHA lending patterns.[36] Although FHA helped to promote safer and wiser practices in such areas as construction, appraisal, and escrows, its underwriting criteria also mandated that FHA-insured homes be located in racially homogeneous neighborhoods. This official sanction for racial segregation assumed that homes in integrated neighborhoods would not hold their value. This discredited theory was officially overturned by a 1962 Kennedy administration action (Executive Order 11063) mandating equal opportunity in federal mortgage programs.

Some homeownership assistance programs seem to work better than others at promoting racial integration. Most obviously, demand-side mortgage credit programs—such as direct subsidies, affordable lending, and the like—appear to promote racial and economic integration more effectively than supply-side efforts to increase the housing stock in poor neighborhoods. Potential homeowners who are given subsidies to support purchases in the neighborhood of their choice have been shown to move to better neighborhoods than those that move into new owner units created in poorer neighborhoods (Urban Institute 1998; Cummings and DiPasquale 2001). Cummings and DiPasquale found that recipients of direct subsidies tended to move to better neighborhoods that had higher average incomes and home prices than the neighborhoods they were leaving. Whites also made up a larger percentage of the population in these settlement neighborhoods. Similar findings were reported in the study on the use of HOME funds (Urban Institute 1998). By contrast, the Cummings and DiPasquale study found that residents who chose to move to new housing developed in inner-city neighborhoods often found themselves residing in mostly, if not entirely, black communities that were poorer than the ones in which they rented, with higher rates of crime and lower-quality schools.

4. Help households build wealth.

Almost all programs that promote homeownership among traditionally underserved groups have the potential to increase household wealth through increased equity,[37] though not all owners will see this benefit (Belsky and Duda 2002). If a home sustains its value or increases in price, *and* the homeowner is not driven into default and foreclosure by the cost of owning and maintaining the

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[36] Nationally, the massive post–World War II expansion of homeownership encouraged by FHA and other government programs also arguably fueled sprawl. Many argue that this urban form emptied central cities, promoting segregation and encouraging inefficient and inequitable land use patterns. FHA lending also has been repeatedly vulnerable to various abuses and scams, destroying neighborhoods and communities. In particular, as FHA lending became more targeted to poorer, minority neighborhoods, illegal and unethical practices, such as property flipping, equity skimming, and inflated appraisals tipped many of these communities into severe decline through high vacancy rates, eroded property values, and bankrupt families.

[37] Some direct subsidy programs that typically provide down payment assistance and/or new unit production may limit equity gains through recapture mechanisms to preserve future unit affordability.

house, equity can build. Home equity can prove an especially critical route to increased household wealth for low-income and minority households (Boehm and Schlottmann 2001). McCarthy, Van Zandt, and Rohe (2001), for example, found home equity accounted for 45.2 percent of net worth for all households. It accounted for 44.5 percent of net worth for whites, but 61.1 and 60.7 percent, respectively, for blacks and Hispanics. Housing wealth, in short, frequently accounts for most of the wealth of low-income and minority households.

Besides the accumulation of wealth, there are added financial benefits of homeownership (McCarthy, Van Zandt, and Rohe 2001) that can be used as indirect tools to increase wealth. For instance, over time, owners may devote a lesser share of their income to mortgage payments than renters do to rent. Assuming fixed long-term mortgage debt and increasing incomes over time, mortgage costs for homeowners may diminish as a share of income, while renters must always be concerned with the possibility of ever-increasing rents. Homeownership also provides access to capital through improved and/or increased credit access, such as second mortgages, senior annuity mortgages, unsecured debt, and home equity lines of credit. Stability in housing costs and leverage are both platforms through which additional wealth can be created.

Though housing wealth accounts for a vast majority of total assets for low-income and minority homeowners, research has shown that those households are not receiving as much value for their home as their white counterparts. Rusk (2001) found that when income is equalized, black homeowners received 18 percent less value for their homes than white owners. Looking at the median income and median home prices, for every dollar of income, white owners owned $2.64 worth of house. Black owners, on the other hand, owned only $2.16 worth of house for every dollar of income. Rusk considers this 18 percent difference in home-value-to-income ratio a “segregation tax” that blacks pay as a result of living in racially segregated neighborhoods with homes experiencing slower than average appreciation.

Predicting whether homeownership will build assets is often dependent on highly localized circumstances. For example, Boehm and Schlottman (2001) and Belsky and Duda (2002) note that most research has focused on the *average* appreciation rates of either low-cost homes or homes in low-income neighborhoods and has rarely examined the household-by-household dynamics of low-income homeownership. They therefore withhold judgment on whether homeownership makes for an effective asset-building strategy.

Other work enumerates the many factors beyond the control of the individual homeowner that can determine whether or not a household actually realizes increased home equity (McCarthy, Van Zandt, and Rohe 2001). Scholarship of this sort has emphasized that wealth building through home equity depends heavily on the location of owned housing (McCarthy, Van Zandt and Rohe 2001; Ambrose and Goetzmann 1998) as well as the costs of maintenance, utilities, and property taxes (Case and Marynchenco 2002) and the timing of home purchase and sale (Belsky and Duda 2002). Advancing from a first to a second or a third home has been shown to enhance wealth accumulation (Boehm and Schlottmann 2001). Minority households, irrespective of income, prove less likely to move up the housing—and implicitly the wealth—ladder (Bradley and Zorn 1997).

5. Strengthen families.

Rhetoric about the benefits of homeownership has often explicitly connected it with strong families. Interestingly enough, only recently has a limited but growing research literature emerged to support such claims. Homeownership frequently does provide safer housing, greater family stability, and improved access to community supports, particularly if it is located in a good neighborhood.

McCarthy, Van Zandt, and Rohe (2001) and Green (1997) both found that households moving from renting to homeownership tended to improve the condition, safety, and size of the units they were living in, although Collins, Crowe, and Carliner (2002) observed that first-time, low-income buyers tended to buy older, smaller homes in poorer condition than those of others. Cummings and DiPasquale (2001) and Harkness and Newman (2003) also caution that despite improvements in unit condition, some homeowners were found less likely to improve their neighborhood by moving to homeownership.

Other work has documented other benefits of homeownership. Rohe, Van Zandt, and McCarthy (2002) also confirmed that homeownership stabilizes and benefits families by increasing satisfaction and by improving the psychological and physical well being of the individual. This work identifies an array of psychological benefits from homeownership, mostly tied to enhanced self-esteem associated with achieving a fundamental source of status in American life.

Some evidence points to positive impacts on homeowners' physical health, while additional work suggests that the benefits that homeownership imparts to owners can translate into significant benefits for their children. By changing the internal environment of the home, homeownership can positively affect parenting practices, the physical environment, residential mobility, and wealth, report Harkness and Newman (2003). Homeownership can provide a stable placement in the community that can greatly improve a family's network of social and neighborhood ties, or social capital, which is important in determining child outcomes (Haurin, Parcel, and Haurin 2002). Children's cognitive outcomes and behavior also appear to be aided by the improvement of a family's home environment through homeownership (Haurin, Parcel, and Haurin 2002; Boehm and Schlottmann 1999). These findings can all lead to higher educational attainment and greater future earnings.

Parental homeownership has also been shown to reduce the tendency of children to participate in deviant behaviors—such as the probability of 17-year-olds dropping out of high school or giving birth (Haurin, Parcel, and Haurin 2002). There is also an increased probability that the children of homeowners will become homeowners 10 years after leaving their parents' home (Boehm and Schlottmann 1999; Haurin, Parcel, and Haurin 2002).[38]

Rohe, Van Zandt, and McCarthy (2002) also describe numerous socially desirable behaviors that homeownership may elicit from owners. Through homeownership, homeowners acquire

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[38] Boehm and Schlottmann (1999) believe that housing is a "merit good," such as education, health care, or nutrition that is underconsumed by those who are not aware of the benefits homeownership can provide because they have not been exposed to it.

financial, organizational, and social skills as well as a sense of responsibility that may be transferred to their children (see also Green 1997). Likewise, homeowners' greater stability and reduced transience gives them a greater stake in the community, which can make them better monitors of their own and the neighborhood's children.

Of course, it should be remembered that not all homeowners realize such extensive benefits of homeownership. Some research suggests that the gains of homeownership can all be negated if the neighborhood in which the home is located is poor or in decline. Homeownership in these neighborhoods may not provide access to community supports (Cummings and DiPasquale 2001). However, more recent research (Harkness and Newman 2002) suggests that homeownership in almost any neighborhood benefits children, while neighborhood effects are weak. The authors conclude, therefore, that children of renters may benefit more from homeownership—even in more distressed neighborhoods—than from remaining renters and moving to a better neighborhood. Still, they do caution that the more distressed the neighborhood, the less likely children are to benefit.

Rohe, Van Zandt, and McCarthy (2002) caution that low-income owners in particular may not gain as much control over their environment and fortunes as is often believed, given that variable incomes and meager savings make meeting monthly mortgage payments difficult. Mortgage indebtedness can lead to insecurity, anxiety, and fear, especially if there is risk of losing the home. Should an owner default, moreover, the costs of foreclosure, both financial and mental, can be punishing. Homeownership, finally, can tie low-income households to declining areas, with all of the social and economic disadvantages that entails.

On balance, the research literature indicates that homeownership assistance can strengthen families and communities, though much more work needs to be done to obtain higher quality data, characterize the particular gains realized by lower-income families, and "unbundle" these benefits from gains that may result from other possible causes (Harkness and Newman 2002).

6. Link housing with essential supportive services.

The housing literature has not focused on the promotion of homeownership and its relationship to supportive services. In housing programs, services have generally been delivered in conjunction with rental housing. Interestingly, homeownership is implicitly linked to supportive services from two unexpected sources: the disabled and aging communities. Both communities have promoted policies that maintain their target populations in their highest level of independent living. Community-based services provided in the home arguably offer more cost-effective alternatives than premature or inappropriate higher levels of care offered in other residential and institutional settings. Such services arguably link supportive services to housing, and, although not specifically intended to, can preserve homeownership.

One other minor example that potentially links housing—specifically homeownership—to supportive services is the home equity conversion (HECM) and reverse annuity (RAM) mortgage products. Commonly known as reverse mortgages, these products essentially lend in reverse, as lenders make payments over time to aging homeowners who want to access their home equity to use for other purposes. Many argue that the proceeds of HECMs or RAMs could be used to support in-home care for elderly homeowners, preventing premature institutionalization. Some propose that these proceeds could also be used to support the cost of long-term care insurance.

7. Promote balanced metropolitan growth.

The degree to which the promotion of homeownership supports balanced metropolitan growth and the health of existing neighborhoods depends on two variables: the location of affordable units in a region, and the general “neighborhood effects” of homeownership on communities. On regional location, the promotion of homeownership has a mixed record of supporting metropolitan health. By contrast, the literature shows such programs have a clearly beneficial impact at the smaller-scale neighborhood level.

The location of affordable housing units tends not to promote balanced metropolitan growth, given the location of most new and existing affordable housing. As noted in Chapter 2, most federally subsidized rental housing production has occurred in central cities rather than suburbs, and in low-income and distressed neighborhoods rather than areas of high job growth. The same is true of homeownership production programs. Additional research suggests that the most affordable units available for ownership in most regions are found in lower-income and distressed neighborhoods.

Neither of these locations supports the ideal of balanced growth across metropolitan regions. The availability of affordable housing mostly in distressed urban neighborhoods tends to concentrate low-income families, keep core neighborhoods weak in comparison with more affluent areas, and drive higher-income residents away toward the suburbs. McCarthy, Van Zandt, and Rohe (2001) mention a final metro-scale problem—that homeownership can actually exacerbate the spatial mismatch between jobs and housing by discouraging household mobility. While renters can more easily move closer to a job (assuming they can find an affordable rental unit), homeowners face high transaction costs in changing their residence, therefore limiting the ease with which they can move to employment centers.

At the same time, homeownership assistance plays a much more beneficial role at the neighborhood level. A review of existing literature by Rohe, Van Zandt, and McCarthy (2002) linked high levels of homeownership to neighborhood stability, while low homeownership rates have been empirically correlated with high levels of social problems. Critical to this stabilizing effect is the fact that homeowners move less frequently than renters: a positive facet of the reduced mobility discussed previously. This reduces resident turnover (Rohe, Van Zandt, and McCarthy 2002; Scanlon 1998; Green 1997). Reduced mobility, along with greater economic investment in their homes, causes homeowners to take better care of their property. This, in turn, increases property values and improves the overall social health of an area (Rohe, Van Zandt, and McCarthy 2002; Scanlon 1998).

And there are other benefits. One study that examined the impact of several projects sponsored by community development corporations around the country inferred that the construction of new ownership units appeared not only to strengthen local residential real estate markets but also to increase commercial activity (retail sales and commercial real estate sales) and even decrease crime (Higgins 2001). Ellen et al. (2002) found that two homeownership programs (Nehemiah and the NY Housing Partnership in New York City) appear to have had a positive impact on the surrounding neighborhood, though it is unclear why. Galster's (2003) review of the literature examining the impacts of both affordable and multifamily housing on the market values of nearby single-family homes found that affordable owner-occupied units seemed generally to have positive effects on the surrounding neighborhood. Large concentrations of new construction and rehabilitation in a community were seen as beneficial, and affordable owner-occupied developments were found to impart greater benefits than affordable renter-occupied ones.

Some research underscores the limits of homeownership as a metropolitan revitalization strategy. Rohe, Van Zandt, and McCarthy (2002) and Scanlon (1998) observe that the decreased mobility associated with homeownership may actually entrench households in low-income neighborhoods, perpetuating social problems found in these areas. Several studies indicate that homeownership revitalizes neighborhoods most when it is accompanied by a comprehensive package of initiatives, including improved services and infrastructure, as well as the creation and rehabilitation of rental housing (Scanlon 1998; Boehlke 1997; Rohe, Van Zandt, and McCarthy 2002).

Cummings and DiPasquale (2001) question whether scarce funding should be used to promote homeownership in distressed neighborhoods. They suggest that the goal of neighborhood revitalization may be better served by investment in entire communities than by homeownership assistance, given the cost of the subsidies frequently provided and the relatively small number of people helped in the programs they studied. They suggest that neighborhoods should be assessed to determine if the communities would benefit more from direct *neighborhood* revitalization efforts. Money can be better spent, they suggest, if it is used to reduce crime, improve schools, and promote economic development. This could attract new residents while improving conditions for families already living there.

C. Implications for Local Action

The promotion of homeownership has been a major focus of American housing policy, and this examination of program impacts highlights both the benefits and shortcomings of this strategy. We conclude that homeownership should be promoted with caution among underserved households. Evidence is building that supports the long-espoused—but relatively undocumented—rhetoric about the benefits of homeownership. Not every homeowner will, however, see all of the benefits of homeownership, and some may even suffer as a result of making poor housing decisions. Exhibit 2 below summarizes what the literature says about how well homeownership assistance programs, on both the supply and demand sides, meet our seven policy goals.

Exhibit 2: Homeownership Assistance—Summary of Findings

	Homeownership Assistance		
	Supply-Side Mortgage Credit	**Demand-Side Homebuyer Tax Policies and Assistance**	**Supply-Side Production**
Preserve and Expand the Supply of Good-Quality Housing Units	Maybe—but impact is indirect	Maybe—but impact is indirect	Yes—primary goal of these programs is expanding owner-occupied stock
Make Housing More Affordable and More Readily Available	Yes— but impact is indirect	Yes—enhances buying power, but depends on price of housing stock	Yes—primary goal of these programs is affordability and access
Promote Racial and Economic Diversity	Possibly—depends upon locational decisions of buyers	Possibly—if recipients can find units in diverse neighborhoods	Possibly—depends on location of units produced and local economy
Help Households Build Wealth	Yes—but depends on house price appreciation and individual borrower circumstances	Yes—but depends on house price appreciation and individual borrower circumstances	Yes—but depends on house price appreciation, individual borrower circumstances
Strengthen Families	Yes–but less impact if units are located in distressed neighborhoods	Yes—but less impact if units are located in distressed neighborhoods	Yes—but less impact if units are located in distressed neighborhoods
Link Housing With Essential Supportive Services	No	Probably not—unless services are explicitly linked with assistance	Probably not—unless services are explicitly linked with assistance
Promote Balanced Metropolitan Growth	Unclear—depends on general population's locational choices	Unlikely—though possible if recipients can find units in suburban areas and close to job opportunities	Rarely—the location of units thus far has generally not promoted balanced growth; however, neighborhoods have benefited from homeownership

What should policymakers on the frontlines of affordable housing take away from the literature on homeownership assistance programs? First and foremost, the literature suggests that **federal initiatives have had a tremendous impact on the expansion of homeownership**, mostly in the form of the regulatory pressure that government has placed on lenders and the GSEs to meet the financing needs of underserved people and places. The federal architecture that essentially created and continues to nurture our current mortgage market (i.e., supply-side mortgage credit) has been extremely successful in promoting greater availability of generally affordable mortgage credit for the vast majority of American home buyers. However, most major interventions have predominantly focused on mortgage credit, rather than the physical stock of housing. The relative emphasis, in terms of funding and priority, on supply-side production has been minimal. To the extent that homes have been built and/or rehabilitated, it has often occurred in distressed neighborhoods needing broader community investment. In the end, for local policymakers, advocates and administrators, the upshot is clear: Federal lending criteria and fairness standards remain the most important impetus to homeownership in local areas of the United States.

Before using the tools that are available to promote homeownership, **local officials need to tailor homeownership strategies to local market realities**. They should have a clear understanding of the configuration of their local homeownership and mortgage market. What is the pattern of homeownership in their community? What is the quality of the homeownership stock, and what has been the house price appreciation history? Who are the lenders, realtors, mortgage brokers, and nonprofit organizations, and in what areas are they active? What public investments are planned, and where? Many local governments and/or housing and redevelopment authorities will have already assembled some of this information as part of their local planning process or for assessments mandated for receipt of certain federal funds.

Armed with this local "map," officials can design strategies to promote action. Again, the nature of action is highly dependent on local circumstances and a careful assessment of neighborhood and household needs. Does the neighborhood need new ownership units? Can it rehabilitate existing units? Or should it take steps to make existing units more affordable? In most places, a combination of these three approaches will be appropriate, but it is important to know what mix will provide the optimal housing situation.

This assessment should also determine where affordable homeowner units will be placed, as **the actual location of affordable homeownership units is extremely important.** Location determines whether or not a family will see the value of its home appreciate. Location influences the types of social benefits—if any—their children may realize. And the location of the affordable housing needed by lower-income and minority households will determine whether or not homeownership assistance strengthens neighborhoods and the metropolitan area, or weakens them. In communities that cannot support homeownership, community reinvestment may be far more practical and effective than simply promoting homeownership. Relying on homeownership to improve poor and distressed areas may not stabilize and revitalize these neighborhoods and may even prove costly to the families who purchase there.

As most policies work to make existing owner units more affordable, **the importance of wealth and income cannot be overlooked.** Discussion in this chapter clearly points to supply- and demand-side mortgage credit programs and interventions as the most successful homeownership strategies that promote the goal of making existing housing affordable and available. While these interventions enable more households to move to homeownership, they do not address the underlying problem—some households do not have enough wealth or income, or both, to own. Strategies that help households build wealth, through increased savings, and help develop their income earning potential, through job training and education, would allow more low- and moderate-income households to become owners without having to rely on special consumer products.

Finally, the literature stresses that **policymakers, practitioners, and others should not oversell the idea of homeownership.** Not all households are guaranteed to see all of the benefits of owning, and homeownership poorly or inappropriately delivered can be more damaging than the status quo to families, as well as the health and fabric of the community. This fact has practical implications for program administration. Most notably, potential low-income and minority homeowners need to be made aware of the risks associated with homeownership so that they can make better-informed housing decisions (Goetzman and Spiegel 2002; Belsky and Duda 2002). Clearly, there are those for whom homeownership is not a viable option. For them, other housing choices should be available in the community. For those who are ready to buy a home, homeownership assistance should go beyond just getting a household into a home; the assistance also should be designed to work on keeping them in a home.

D. Research Gaps

As this review has shown, homeownership has been the focus of a great deal of both empirical and qualitative research. However, this evaluation of homeownership as a means of achieving the seven policy goals shows that there is still a great deal we don't know. While there is no doubt that homeownership can be beneficial, more research needs to be conducted on both the social and economic impacts of homeownership for families, with a special focus on the children of homeowners (Rohe, Van Zandt, and McCarthy 2002; Boehm and Schlottman 1999; McCarthy, Van Zandt, and Rohe 2001). All of our notions concerning the benefits of homeownership are based on the traditional model—suburban locales, and white, middle-income households. The existing literature rarely looks at the effects of homeownership across income levels or racial lines (Rohe, Van Zandt, and McCarthy 2002; Gyourko, Linneman, and Wachter 1999). Additional data is also needed on the impacts of the location of affordable owner housing. While Rusk (2001) found that higher degrees of residential segregation resulted in wider gaps between the housing values of black and white homeowners, there needs to much more research on this topic as it affects one of the biggest benefits of owning—building wealth. Gathering all if this information is extremely important as homeownership is promoted more and more among low- and moderate-income families and minorities to help close persistent gaps in homeownership rates.

While the drive to increase homeownership among underserved groups has brought homeownership to more urban neighborhoods, with varying levels of stability, and to minorities and lower-income households, the research has been slow to catch up and document what homeownership means for these groups and in these places. Though the benefits of owning are delineated, few studies describe under what circumstances a household may see these benefits, and which types of households are more likely to benefit from owning. We can infer homeownership's impacts, but without empirical analysis, proponents of low- and moderate-income homeownership may be promoting owning among groups that are not yet ready for this responsibility, or in neighborhoods where prevailing conditions may negate the benefits of owning. In addition, as more traditionally underserved households strive for and attain homeownership, the importance of homeowner education and counseling cannot be stressed enough, nor can the need for more studies looking at its effectiveness, both pre- and post-purchase.